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Nos. 03-892 and 03-907

SUPREME COURT, U.S.
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In The Supreme Court of the United States

COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

v.

JOHN W. BANKS, II

COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

v.

SIGITAS J. BANAITIS

On Writs Of Certiorari To The United States Courts Of Appeals For The Sixth And Ninth Circuits

JOINT SUPPLEMENTAL BRIEF FOR RESPONDENTS

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JOINT SUPPLEMENTAL BRIEF FOR RESPONDENTS

Pursuant to Rule 25.5 of this Court, Respondents in the above-entitled cases, which have been consolidated for oral argument on November 1, 2004, submit the following joint supplemental brief. The purpose of this supplemental brief is to call to the Court's attention newly enacted legislation, which the president signed into law October 22, 2004. While the new legislation is not retroactive, it nevertheless will limit sharply the impact of any decision rendered by the Court in future cases involving substantially the same facts. There is thus a possibility that the Court may conclude, upon examination of the new legislation, that both cases should be dismissed on the ground that the writs of certiorari were improvidently granted.

On October 22, 2004, the president signed the *American Jobs Creation Act of 2004*. Section 703 of the Act, entitled Civil Rights Tax Relief, amends section 62(a) of the Internal Revenue Code by expressly permitting a taxpayer to subtract from his or her gross income, in arriving at adjusted gross income, the "attorneys fees and court costs paid by, or on behalf of, the taxpayer in connection with any action involving a claim of unlawful discrimination" as defined by the Act. Section 62(e) of the Internal Revenue Code, as amended by the Act, defines the term "unlawful discrimination" as an act that is unlawful under various enumerated federal, state, and local statutory provisions, as well as common law claims. Section 703 is reproduced in an Appendix to this Supplemental Brief.

Significantly, Internal Revenue Code section 62(a), as amended by the Act, includes as "unlawful discrimination"

acts which gave rise to the tax disputes in both Respondents Banks's and Banaitis's respective cases. Respondent Banks's underlying discrimination claims, which gave rise to his current tax dispute with Petitioner, were based on violations of: (1) Title VII of the Civil Rights Act of 1964, as amended, 42 U.S.C. section 2000e *et seq.*; and (2) 42 U.S.C. sections 1981 and 1983. No. 03-892, Pet. App. 1a-5a. Internal Revenue Code sections 62(e)(13) and (14), as amended by the Act, expressly include as "unlawful discrimination" acts which violate 42 U.S.C. section 2000e-2, 2000e-3, 2000e-16, and 42 U.S.C. sections 1981 and 1983. Moreover, Respondent Banaitis's underlying claims, which gave rise to his current tax dispute with Petitioner, were based on state common law claims for wrongful discharge and tortious interference with contract by his former employer. No. 03-907, Pet. App. 4a. Internal Revenue Code section 62(e)(18)(ii) expressly includes as "unlawful discrimination" "[a]ny provision of * * * State, or local law, or common law claims permitted under * * * State, or local law – regulating any aspect of the employment relationship, including claims for wages, compensation, or benefits, or prohibiting the discharge of any employee."

The new legislation applies to attorneys fees paid after the date of enactment with respect to any settlement or judgment occurring after its enactment. The new legislation thus does not apply to Respondent Banks's or Banaitis's respective tax disputes with Petitioner. However, any decision of this Court will have little or no impact on future tax disputes involving substantially the same facts. Moreover, prudential considerations, including deference to the coordinate branches, may warrant a

determination that a decision as to the merits should not be reached in either of these cases. A decision on the merits in favor of Petitioner in either or both cases would lead to disparate tax consequences for federal and state discrimination claimants, depending on the date when judgment was rendered or settlement was reached with respect to their claims.

A final consideration which may warrant dismissal in each case on the ground that the writ of certiorari was improvidently granted is that Sen. Charles Grassley, the Chairman of the Senate Finance Committee, stated on the Floor of the Senate, shortly following passage of the Act by Congress, that the portion of the Act relevant to each of these cases was designed to *clarify* and not change existing law, and that judgments rendered or settlements reached prior to the effective date of the Act should be treated identically as judgments and settlements subject to the Act:

> Mr. BAUCUS. As I understand it, the case law with respect to the tax treatment of attorney's fees paid by those that receive settlements or judgments in connection with a claim of unfaithful discrimination, a False Claims Act, "Qui Tam," proceeding or similar actions is unclear and that its application was questionable as interpreted by the IRS. Further it was never the intent of Congress that the attorneys' fees portions of such recoveries should be included in taxable income whether for regular income or alternative minimum tax purposes.

> Is it the understanding of the chairman that it was the conferees' intention for Section 703 to clarify the proper interpretation of the prior law, and any settlements prior to the date of enactment should be treated in a manner consistent with such intent?
>
> Mr. GRASSLEY. The Senator is correct. The conferees are acting to make it clear that attorneys' fees and costs in these cases are not taxable income, especially where the plaintiff, or in the case of a Qui Tam proceeding, the relator, never actually receives the portion of the award paid to the attorneys. Despite differing opinions by certain jurisdictions and the IRS, it is my opinion that this is the correct interpretation of the law prior to enactment of Section 703 as it will be going forward. In adopting this provision, Congress is codifying the fair and equitable policy that the tax treatment of settlements or awards made after or prior to the effective date of this provision should be the same. The courts and IRS should not treat attorneys' fees and other costs as taxable income.
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> * * *
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> [I]t is my strong belief that the courts and the IRS should apply the guidelines of Section 703 not only after the date of enactment but also to settlements put in place prior to that time.

150 CONG. REC. S11036 (daily ed. October 10, 2004). A dismissal would thus be consistent with that legislative history, because both Banks and Banaitis prevailed below.

For the foregoing reasons, the late developments described above may warrant dismissal of both of the consolidated cases on the ground that the writs of certiorari were improvidently granted.

Respectfully submitted,

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